



CITY OF CAPE TOWN  
ISIXEKO SASEKAPA  
STAD KAAPSTAD

## **ANNEXURE 28**

# **NATIONAL TREASURY CIRCULAR 89 AND CIRCULAR 91 - MUNICIPAL BUDGET CIRCULARS FOR THE 2018/19 MTREF**

# Municipal Budget Circular for the 2018/19 MTREF

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## Introduction

The purpose of the annual budget circular is to guide municipalities with their compilation of the 2018/19 Medium Term Revenue and Expenditure Framework (MTREF). This circular is linked to the Municipal Budget and Reporting Regulations (MBRR); and strives to support municipalities' budget preparation processes so that the minimum requirements of the MBRR are achieved.

In 2010 National Treasury introduced the local government budget and financial reform agenda and since then several projects to further this agenda have been introduced. The recent implementation of the municipal Standard Chart of Accounts (*mSCOA*) and the accompanying "game changers" signals a smarter way forward to strengthening local government finances.

Among the objectives of this budget circular is to demonstrate how municipalities should undertake annual budget preparation in accordance with the budget and financial reform agenda and associated "game changers".

Municipalities are reminded to refer to the annual budget circulars of the previous years for guidance on budget preparation that is not covered in this circular.

### 1. The South African economy and inflation targets

In the 2017 Medium Term Budget Policy Statement the Minister of Finance stated that, improving the country's economic growth in the period ahead remains the biggest challenge. This undoubtedly echoes the sentiments expressed in the previous year's annual budget circular, that the South African economic outlook is bleak.

The National Treasury's macroeconomic projections show that per capita income will continue to stagnate unless appropriate financial decisions are taken. This implies that a new course of action is required to break the cycle of weak growth, escalating government debt, increasing unemployment and declining investment and business confidence.

It is important to note that the 2017 projected Gross Domestic Product (GDP) growth forecast of 1.3 per cent in the 2017/18 budget was revised down to 0.7 per cent. The rate of recovery will be slow and at this time, it is anticipated that growth of 1.9 per cent may be reached by 2020.

Notably, the anticipated economic improvements, employment opportunities and business recovery have not materialised hence the economy remains unstable. The impact of the decline in mining growth and the struggle in the agriculture sector because of the persistent drought influence the low economic growth.

The mining outlook remains subdued due to continued domestic policy uncertainty and rising production costs. Fixed-capital stock in manufacturing has declined every year since 2009, indicating a gradual erosion of capacity. Formal non-agricultural employment declined by 0.2 per cent in the first half of 2017 compared to the same period last year. Employment prospects in manufacturing remain constrained. Similarly, employment growth in the trade sector is likely to remain under pressure given low consumer confidence and weak credit growth.

In summary, the country's tax collection targets have not been met and this means that the fiscus has less funds available to allocate across the various spheres of government. Unfortunately, a similar decline cannot be measured in expenditure and this means that deficits are growing.

The following macro-economic forecasts must be considered when preparing the 2018/19 MTREF municipal budgets.

**Table 1: Macroeconomic performance and projections, 2016 - 2020**

Fiscal year	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Forecast		
CPI Inflation	6.3%	5.4%	5.2%	5.5%	5.5%

Source: Medium Term Budget Policy Statement 2017.

Note: the fiscal year referred to is the national fiscal year (April to March) which is more closely aligned to the municipal fiscal year (July to June) than the calendar year inflation.

## 2. Key focus areas for the 2018/19 budget process

### 2.1 Local government conditional grants and additional allocations

The proposed division of revenue continues to prioritise funding services for poor communities. Allocations to local government subsidise the delivery of free basic services to low-income households, and the infrastructure needed to deliver those services.

The 2017 Medium Term Budget Policy Statement (MTBPS) indicates transfers to local government for the 2018 MTREF are R397 billion, of which 62.2 per cent comprise unconditional allocations while the remainder is conditional grant funding. The allocations for local government over the medium term represent 9.2 per cent of non-interest expenditure and an increase of 8.3 per cent.

The equitable share and the allocation of the general fuel levy to local government constitute unconditional funding. Municipalities are reminded that this funding allocation is formula driven and designed to fund the provision of free basic services to disadvantaged communities. Conditional grant funding must be utilised for the intended purpose within the timeframes, as specified in the annual Division of Revenue Bill. Monies not spent must be returned to the fiscus and requests for roll-overs will only be considered in extenuating circumstances.

The annual Division of Revenue Bill will be published in February 2018 after the Minister of Finance's budget speech. The grant allocations will be specified in this Bill and municipalities must reconcile their budgets to the numbers published herein.

Municipalities are advised to use the indicative numbers presented in the 2017 Division of Revenue Act to compile their 2018/19 MTREF. In terms of the outer year allocations (2020/21 financial year), it is proposed that municipalities conservatively limit funding allocations to the indicative numbers as proposed in the 2017 Division of Revenue Act for 2018/19. The DoRA is available at <http://www.treasury.gov.za/documents/national%20budget/2017/default.aspx>

### Changes to local government allocations

- The Equitable Share formula takes into account the rising bulk costs of electricity and water, as well as household growth. This is confirmed by the additional R1.5 billion in 2019/20 that was part of the 2017 budget for the *local government equitable share*.
- In line with government's Integrated Urban Development Framework (IUDF), a new approach to funding intermediate cities will be piloted as part of the *municipal infrastructure grant* in 2018/19. It will emphasise a programme of capital investment that

combines grant and non-grant funding. This approach may take the form of a separate grant for qualifying cities over the medium term, with strong performance incentives.

- The allocation mechanism of the *public transport network grant*, which funds the improvement of urban public transport systems, will be amended. The changes will provide more stability in allocations for smaller cities. Performance incentives will be introduced and stricter conditions applied. Where cities fail to demonstrate that they have financially sustainable plans for public transport networks, allocations will be cut. Performance incentives will also be considered for other conditional grants, including for improved spending on infrastructure maintenance.
- The National Treasury and the Department of Human Settlements will review spending on urban informal settlement upgrading, with a view to changing the grant system to enable increased investment in in-situ upgrading. This work will be aligned to the review of the provincial *human settlements development grant*.

The Presidency announced in a press statement on 27 November 2017 that, “President Jacob Zuma has directed the Minister of Finance, Mr Malusi Gigaba, assisted by the Presidential Fiscal Committee, to identify concrete measures to urgently address the challenges identified in the Medium Term Budget Policy Statement.” These measures should focus on four areas, one of which is, “To identify and finalise proposals for cuts in expenditure amounting to about R25 billion. Such proposed cuts should not be in areas that will negatively affect economic growth prospects and job creation.” National Treasury is currently working to implement this directive from the President. If the proposed cuts in expenditure are adopted by Cabinet, they could result in substantial changes to the division of revenue that was tabled in the 2017 MTBPS. Municipalities should be aware in their planning that these changes could include substantial reductions to grants to local government. The details of any cuts to expenditure will be announced when the 2018 Budget is tabled on 21 February 2018.

### ***Reforms to local government fiscal framework***

Reforms over the medium term will enhance the ability of municipalities to raise revenue to invest in their own development.

Government will:

- Table amendments to the Municipal Fiscal Powers and Functions Act (2007) to better regulate the levying of municipal development charges; and
- Update the policy framework for municipal borrowing and financial emergencies. The purpose is to establish a system which does not only guarantee stability and certainty in local government finances, but also seeks to implicitly create incentives and attract more players in the municipal debt market space, i.e. insurers, pension funds, fund managers and DFIs.

Municipal revenue-raising capacities vary widely. The National Treasury will consider applications to waive co-funding requirements for infrastructure projects in municipalities with little or no ability to raise finance for such projects. Reprioritisations within the *regional bulk infrastructure grant*, *water services infrastructure grant* and *municipal infrastructure grant* will be made to fund the Bucket Eradication Programme.

## 2.2 Municipal Standard Chart of Accounts (*mSCOA*)<sup>1</sup>

The implementation of *mSCOA* Regulations from 01 July 2017 revealed some of the challenges with version 6.1 of the chart that must be addressed. As a result of this, the chart was updated and version 6.2 is released with this circular (see Annexure A). Version 6.2 of the chart will be effective from 2018/19 and must be used to compile the 2018/19 MTREF. In addition, there were classification differences between the original budgets that were adopted by municipal council and the data strings that were submitted to National Treasury. Furthermore, the budget related policies were not updated to align to *mSCOA* (e.g. Virement policy).

Version 6.2 of the *mSCOA* chart to be used for the 2018/19 MTREF is available on the link below:

<http://mfma.treasury.gov.za/RegulationsandGazettes/MunicipalRegulationsOnAStandardChartOfAccountsFinal/Pages/default.aspx>

### ***Amendments of mSCOA implementation errors during the adjustments budget***

During the budget verification process it was evident that municipalities had challenges aligning the *mSCOA* original budget data string to the original budget adopted by municipal council. The challenges differed per municipality and include differences on classification. Most municipalities were granted permission to correct the alignment during the 2017/18 adjustments budget process. The adjusted budget data strings should align to Schedule B adopted by municipal council. National and Provincial treasuries will undertake the verification process on the adjusted budgets in relation to the data strings. Therefore, municipalities are advised to submit the draft data strings and B-schedules in advance for testing purposes to ensure that aligned documents are adopted by municipal council by 28 February 2018.

### ***The impact of mSCOA on the virement policy***

MFMA Circular No. 51 highlighted the principles that must be incorporated into municipal virement policies. It also emphasised that the policy must indicate how the virement process must be managed within the municipality to enable the tracking and reporting of funding shifts.

The principles are still applicable and relevant. The only difference is that a transaction in *mSCOA* relates to six regulated segments, therefore all segments must be considered when making a virement. Municipalities are urged to review the policy and update reference to "Vote" to align to the function segment and indicate the funding applicable to the item being transferred in relation to the funding segment. Therefore, with the implementation of *mSCOA*, virements can only take place within a function or sub-function and the same source of funding. The creation of new projects or savings across functions can only take place through an adjustment budget. The policy must clearly articulate that virements should not be allowed from the repairs and maintenance project in the project segment.

### ***Clarification of core and non-core functions***

There are municipalities that experienced challenges with the implementation of the function segment due to the interpretation of what is core and non-core. Core functions provides for the matters in terms of section 156 (1) of the Constitution. These are functions performed by local government and constitutionally assigned to local government in terms of Part B of Schedule 4 and Part B of Schedule 5. Non-core function refers to the functions performed by

<sup>1</sup> The Minister of Finance promulgated the Municipal Regulations on a Standard Chart of Accounts in government gazette Notice No. 37577 on 22 April 2014.

local government that are constitutionally assigned to provincial government in terms of section 156(4) of the Constitution. Local Government are compensated for delivering these functions on behalf of provincial government and typically receive a management fee from the provincial department.

For example, with the water function, if a municipality is an approved Water Service Authority (WSA), the provision of water will be a core function of that municipality. However, where a municipality is providing the service on an agency basis and is not an approved WSA, this will be a non-core function.

### **2018/19 mSCOA Audit process**

When the *mSCOA* Regulation was promulgated in 2014, it provided for a three-year preparation and readiness window. All municipalities had to be compliant with the *mSCOA* classification framework by 1 July 2017. In order to ensure that municipalities meet the compliance deadline, National Treasury provided technical guidance on the processes required through MFMA Circulars No. 57, 80, 85 and *mSCOA* Circulars 1, 2, 3, 4, 5, and 6. Furthermore, a transversal tender (RT25-2016) was issued to reduce the time spent by municipalities on onerous tender processes and price negotiations when changing its current financial system to comply with *mSCOA*. These circulars read together with the *mSCOA* regulations should be the first point of departure when municipalities prepare their *mSCOA* audit files and the following key documents should typically be included in the audit files:

- Governance: Council resolutions pertaining to *mSCOA* implementation, including the resolutions to establishment a *mSCOA* steering committee and project implementation team; all documents of the Project Steering Committee and Project Implementation Committee such as agendas, attendance registers, signed minutes of all meetings, correspondence with National and Provincial Treasuries and the *mSCOA* project plan and reports/evidence of monitoring thereof;
- Change management and training: Records as evidence that change management were implemented and that all officials were trained on *mSCOA* and the use of the *mSCOA* enabling financial system;
- Procurement of Systems: Evidence that the processes set out in Annexure B of *mSCOA* Circular No. 6 was followed, including conducting an ITC due diligence process, obtaining a recommendation from the *mSCOA* project steering committee and the views of the National/Provincial Treasury and correspondence with the Office of the Procurement Officer (OCPO) of National Treasury where the transversal tender RT25-2016 was used; and
- Data migration/conversion: As part of the audit process, the Auditor-General will review the conversion/migration/cleansing processes used by the municipality to assess the completeness, accuracy and validity of data.

Municipalities are advised to use their internal audit function to ensure that the correct process was followed. Internal audit must ensure that the municipality has complied with the requirements of *mSCOA* and the reports of internal audit must be tabled at audit committee and at municipal council for their consideration.

### **2.3 Reporting indicators**

The National Treasury has finalised the process of rationalising the built environment reporting for the eight metropolitan municipalities with an aim to reduce the reporting burden, which included the development of a set of indicators that will enable government to monitor progress on the integrated and functional outcomes.

There has been some confusion as to the level that indicators in the Service Delivery Budget Implementation Plan (SDBIP) occupy, particularly in relation to quarterly projections of service delivery targets and performance indicators for each vote (as per MFMA Circular No. 13).

Municipalities are urged to refer to MFMA Circular No.88 on rationalisation of planning and reporting requirements for the 2018/19 MTREF issued on 30 November 2017. The circular contains municipal performance indicators for metropolitan municipalities. In providing guidance, conceptual clarity and alignment between the Integrated Development Plan (IDP), Built Environment Performance Plan (BEPP), SDBIP and the performance part of the Annual Report, the MFMA Circular has conceptual application of benefit to all municipalities.

The performance indicators will be applicable to metropolitan municipalities from the 2018/19 financial year, and incrementally introduced to other categories of municipalities from 2019/20 onwards, although earlier compliance is encouraged.

## **2.4 Borrowing for capital infrastructure**

In terms of Section 46 of the MFMA, a municipality may incur long-term debt only for the purpose of current or future capital expenditure on property, plant or equipment, and in specified circumstances for refinancing existing long-term debt. A municipality cannot borrow to replenish capital, nor can borrowing be attributed to previous years' investment projects.

It has come to National Treasury's attention that some municipalities budget for long-term borrowing in a specific financial year to finance capital projects; however, the expenditure is financed from internally generated funds and not with the planned/ budgeted long-term borrowing as was approved by council. The municipalities will then obtain the long-term debt in future years to refinance the internally generated funds which were used to finance the capital projects in the previous financial years. This practice is not supported as it is not consistent with section 15 of the MFMA that provides that a municipality can only incur expenditure in terms of an approved budget and within the amounts appropriated for the different votes. The incurring of the expenditure against a different source of finance than what was approved will be regarded as unauthorised expenditure.

## **3. The revenue budget**

Similar to the rest of government, municipalities face a difficult fiscal environment. Even as demand for services rises, weak economic growth has put stress on consumers' ability to pay for services, while transfers from national government are growing more slowly than in the past. Some municipalities have managed these challenges well, but others have fallen into financial distress and face liquidity problems. These include municipalities that are unable to meet their payment obligations to Eskom, water boards and other creditors. There is a need for municipalities to focus on collecting revenues owed to them, and eliminate wasteful and non-core spending. Municipal budgets will be scrutinised to ensure that municipalities adequately provide to service their debt obligations. Municipalities must ensure that expenditure is limited to the maximum revenue collected and not spend on money that they do not have.

Municipalities are reminded that, the local government equitable share allocation is mainly to fund the costs of free basic services and to subsidise the administrative costs of the smaller and more rural municipalities. The increasing unemployment and growth in the number of persons per household means that the revenue foregone in respect of free basic services will likely increase and it will become even more difficult to collect revenue. The household budget will be under pressure and trade-offs will be applied as it may be unaffordable to pay all household expenses with regularity.



National Treasury encourages municipalities to maintain tariff increases at levels that reflect an appropriate balance between the affordability to poorer households and other customers while ensuring the financial sustainability of the municipality. The Consumer Price Index (CPI) inflation is forecasted to be within the upper limit of the 3 to 6 per cent target band; therefore municipalities are required to ***justify all increases in excess of the projected inflation target for 2018/19*** in their budget narratives, and pay careful attention to the differential incidence of tariff increases across all consumer groups. In addition municipalities should include a detail of their revenue growth assumptions for the different service charges in the budget narrative.

### **3.1 Maximising the revenue generation of the municipal revenue base**

The implementation of *m*SCOA requires systems integration of several sub-systems such as that which contains the municipal valuation roll. Among the internal controls, the system must have the capability to compare the valuation roll data to that of the billing system; the list of exceptions derived from this reconciliation provides an indication of where the municipality may be compromising its revenue generation in respect of property rates. Municipalities must reconcile valuation roll data, billing system and the deeds office. This may become a formal disclosure item in the near future.

Municipal own revenue sources are shrinking due to widespread drought and households opting for alternative sources of energy. This means that more effort is required to maximise revenue derived from property rates.

### **3.2 Eskom bulk tariff increases**

2017/18 was the last year of the third Multi-Year Price Determination (MYPD) for Eskom's tariffs approved by the National Energy Regulator of South Africa (NERSA). Eskom has applied for a one year average tariff increase of 19.9 per cent for 2018/19. For municipalities, the different timing of the municipal financial year means that the increase Eskom has applied for would mean a 27.29 per cent average tariff increase in the 2018/19 municipal financial year. The National Energy Regulator of South Africa recently concluded a process of public hearings on this application, but has yet to publish a decision on the application. Municipalities can monitor [www.nersa.org.za](http://www.nersa.org.za) for news on the outcome of this process.

Municipalities should note that the average electricity tariff increase for municipalities in the 2017/18 municipal financial year was only 0.31 per cent. MFMA Circular No. 86 noted that by the time that tariff announcement was made, the local government equitable share allocations for 2017/18 had already been calculated with a higher electricity tariff increase. That circular said that "municipalities will have to budget to retain any surplus funds from the higher free basic services subsidy paid [through the local government equitable share] in 2017/18 in order to offset the cost of providing free basic electricity in 2018/19."

Municipalities are also urged to examine the cost structure of providing electricity services and to apply to NERSA for electricity tariff increases that reflect the total cost of providing the service so that they work towards achieving fully cost-reflective tariffs that will help them achieve financial sustainability. Municipalities in arrears with Eskom should ensure that their payment arrangements are effected in their 2018/19 MTREF budget.

### **3.3 Water tariff increases**

The prevailing drought makes it difficult for some municipalities to improve revenue generation from this service. It is now more important to improve demand management, infrastructure maintenance, loss management, meter reading and tariff setting in respect of water services.

Municipalities must ensure that the tariffs charged are able to cover for the cost of bulk purchases, ongoing operations as well as provision for future infrastructure. There are

municipalities that are struggling to pay water boards due to a number of issues, one of which is poor financial sustainability and cost recovery. All municipalities in arrears with bulk suppliers must ensure that their payment arrangements are effected in their 2018/19 MTREF budget.

Accounting officers should take note that failure to undertake proper due diligence in terms of the affordability of payment arrangements and making the necessary provision in the municipality's budget will be considered as an act of financial misconduct and the necessary action in terms of chapter 15 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings will have to be taken.

Municipalities that may have benefited from having introduced penalty tariffs for non-compliant consumers will have to adjust their budgets accordingly.

### **3.4 Water Conservation and Water Demand Management (WCWDM)**

Water Conservation and Water Demand Management has been identified as a key intervention to balance available municipal supply against projected future needs. In this regard municipalities must actively implement WCWDM. Ongoing accurate monitoring and reporting of municipal Non-Revenue Water (NRW) and water loss performance against set targets and baselines is critical. The reporting must take place via the International Water Association (IWA) water balance methodology. No new funding towards future water infrastructure projects will be considered unless municipalities can provide actual consumption figures and prove that their water losses are under control. Municipalities should increase their efforts to reduce NRW and the negative impact it has on their ability to generate their own income and run a viable water business.

## **4. Funding choices and management issues**

The Circular clearly outlines that, as a result of the economic landscape and weak tariff setting, municipalities are under pressure to generate revenue. The ability of customers to pay for services is declining and this means that less revenue will be collected. Therefore, municipalities must consider the following when compiling their 2018/19 MTREF budgets:

- improving the effectiveness of revenue management processes and procedures;
- paying special attention to cost containment measures by, amongst other things, controlling unnecessary spending on nice-to-have items and non-essential activities as was highlighted in MFMA Circular No. 82;
- ensuring value for money through the procurement process;
- the affordability of providing free basic services to all households; and
- curbing consumption of water and electricity by the indigents to ensure that they do not exceed their allocation.

Accounting officers are reminded of their responsibility in terms of section 62(1)(a) of the MFMA to use the resources of the municipality effectively, efficiently and economically. Failure to do this will result in the accounting officer committing an act of financial misconduct which will trigger the application of chapter 15 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings.

### **4.1 Employee related costs**

The *Salary and Wage Collective Agreement* for the period 01 July 2015 to 31 June 2018 has come to an end. The process is under consultation; therefore, in the absence of other information from the South African Local Government Bargaining Council communication will be provided at a later stage.

## **4.2 Remuneration of councilors**

Municipalities are advised to budget for the actual costs approved in accordance with the Government Gazette on the Remuneration of Public Office Bearers Act: Determination of Upper Limits of Salaries, Allowances and Benefits of different members of municipal councils published annually between December and January by the Department of Cooperative Governance. Any overpayment to councilors contrary to the upper limits as published by the Minister of Cooperative Governance and Traditional Affairs will be irregular expenditure in terms of section 167 of the MFMA and must be recovered from the councilor(s) concerned.

## **5. Conditional Grant Transfers to Municipalities**

### **5.1 Non-compliance of in year monitoring**

In terms of Section 74(1) of the Municipal Finance Management Act (No 56. of 2003) (MFMA), municipalities must submit to the National and Provincial treasuries documents and monthly grant return forms as may be prescribed or required. Furthermore, section 12(2) of the Division of Revenue Act (Act No. 3 of 2017) (DoRA) states that the municipality, as part of the report required in terms of section 71 of the MFMA, report on the matters referred to in subsection (4) and submit a copy of that report to the relevant provincial treasury, the National Treasury and the relevant Transferring Officer.

There are municipalities that have not been complying with the reporting requirements as stipulated above. Municipalities are reminded that non-submission of monthly reports translates to non-compliance with the MFMA and DoRA. The National Treasury and Transferring Officer will be implementing stringent measures to municipalities that do not comply with the prescripts. This includes, but is, not limited to the stopping and reallocation of conditional grants funding away from municipalities that are non-compliant. Municipalities are encouraged to comply with the reporting requirements in order to avoid withholding or stopping of an allocation.

## **6. The Municipal Budget and Reporting Regulations**

### **6.1 Tabling of funded budgets**

The importance of tabling funded budgets is highlighted in MFMA Circular No. 74. This is one of the game changers in local government to ensure financial sustainability. As an initiative to support municipalities in this regard, the National and Provincial treasuries are assessing tabled budgets and assisting municipalities in effecting the required changes to ensure that they adopt funded budgets. However, some municipalities have challenges in correcting the budgets to ensure that they are funded in one financial year due to financial challenges. As a result, such municipalities must, together with their 2018/19 MTREF budget, table a plan in a municipal council on how and by when the budget will improve from an unfunded to a funded position. The National and Provincial treasuries will assess the budget together with the plans and support the municipality accordingly.

### **6.2 Budgeting for collections from arrear debtors**

Most municipalities do not split collections between current and arrear debtors when reporting on table A7, this results in the collection rate being overstated. Municipalities are required to only disclose receipts from current accounts under cash flow from operating activities and the receipts from arrear accounts should be disclosed under cash flow from investing activities (Decrease in non-current debtors).

### 6.3 VAT implications (Budgeting on capital (A5) vs reporting)

MFMA Circular No. 58 indicated that municipalities must disclose total capital conditional grant allocations reflected in the DoRA under 'transfers and grants – capital' on Tables A2, A3, A4 and A5. However, there are municipalities that are experiencing challenges when reporting capital expenditure performance against the budget. The expenditure at year end appears to be understated when compared to the budget.

In terms of paragraph 4.5 of the VAT 419 Value-Added Tax – Guide for Municipalities, section 8(5A) was introduced to create a deemed supply where a person receives a grant from a public authority, constitutional institution or municipality. In light of the above it is clear that transfers to municipalities are deemed to be a zero-rated supply which includes VAT at 0 per cent. Grants are therefore VAT inclusive as per MFMA Circular No. 58 but at 0 per cent. ***Therefore, municipalities must budget for VAT at 0 per cent and not 14 per cent on tables A4 and A5.*** The approach also applies to the adjustments budget process (tables B4 and B5).

The fact that grants are a zero-rated supply enables municipalities to claim the input VAT on expenditure incurred. In line with MFMA Circular No. 58 a municipality must report the VAT inclusive expenditure against all conditional grants for purposes of DoRA, failing which the reclaimed input VAT will reflect as 'unspent' and revert to the National Revenue Fund (NRF). In practice the amount of expenditure (VAT exclusive) in the grant register will be expensed/capitalised and the VAT portion reflected in the grant register may be utilised by the municipality as own revenue in terms of MFMA Circular No. 58. This also removes any doubt about the misalignment of Tables SA18, SA19, SA20, A4 and A5 due to VAT.

### 6.4 Budgeting for projections on tables SA25 to SA30

Over the years municipalities in general have not adequately completed the supporting tables SA25 to SA30, where projections were equally divided over twelve months. In addition, the quarterly projections reported on the C schedules differ with the projections that were set in the adopted budgets. This has defeated the purpose of monthly projections which seeks to improve cash flow and performance management. The implementation of *m*SCOA requires municipalities to undertake monthly projections, which must align to the supporting tables of the A schedule. Municipalities must reflect realistic projections when they adopt the budget and not to change the projections during in-year reporting.

### 6.5 Service level standards

A broad guideline was provided on the minimum service standards to be incorporated in the budget documentation. In addition, MFMA Circular No.74 included a framework that was developed as an outline to assist municipalities in finalising their service level standards.

Municipalities are advised to update the service level standards to align to the new IDPs that were compiled after the 2016 Local Government Elections. As indicated in MFMA Circular No.74 it is not possible to have the same service level standards across all municipalities. Therefore, the outline must be used as a guideline and be amended accordingly to align to the municipality's specific circumstances.

### 6.6 Schedule A - version to be used for the 2018/19 MTREF

National Treasury has released Version 6.2 of Schedule A1 (the Excel Formats) which is aligned to version 6.2 of the *m*SCOA classification framework which must be used when compiling the 2018/19 MTREF budget. **ALL** municipalities **MUST** use this version for the preparation of their 2018/19 MTREF budget.

It is imperative that all municipalities prepare their 2018/19 MTREF budgets in their financial systems and that the A1 schedule be produced directly from their financial system. All financial systems must have this functionality to assist and prepare budgets.

Special attention must be given to the supporting schedules in the prescribed A1 schedule. Where detailed data is lying in a sub-system e.g. human resource data for SA22 to SA24, this data must be pulled from the sub-system into the applicable supporting sheet.

Download Version 6.2 of Schedule A1 by clicking [HERE](#)

The Municipal Budget and Reporting Regulations, formats and associated guides are available on National Treasury's website at:  
<http://mfma.treasury.gov.za/RegulationsandGazettes/Pages/default.aspx>

## 6.7 Assistance with the compilation of budgets

If municipalities require advice with the compilation of their respective budgets, specifically the budget documents or Schedule A1, they should direct their enquiries to their respective provincial treasuries or to the following National Treasury officials:

Province	Responsible NT officials	Tel. No.	Email
Eastern Cape	Bernard Mokgabodi	012-315 5936	<a href="mailto:Bernard.Mokgabodi@treasury.gov.za">Bernard.Mokgabodi@treasury.gov.za</a>
	Matjatji Mashoeshoe	012-315 5553	<a href="mailto:Matjatji.Mashoeshoe@treasury.gov.za">Matjatji.Mashoeshoe@treasury.gov.za</a>
Free State	Jordan Maja	012-315 5663	<a href="mailto:Jordan.Maja@treasury.gov.za">Jordan.Maja@treasury.gov.za</a>
	Cethekile Moshane	012-315 5079	<a href="mailto:Cethekile.moshane@treasury.gov.za">Cethekile.moshane@treasury.gov.za</a>
Gauteng	Kgomotso Baloyi	012-315 5866	<a href="mailto:Kgomotso.Baloyi@treasury.gov.za">Kgomotso.Baloyi@treasury.gov.za</a>
	Nomxolisi Mawulana	012-315 5460	<a href="mailto:Nomxolisi.Mawulana@treasury.gov.za">Nomxolisi.Mawulana@treasury.gov.za</a>
KwaZulu-Natal	Bernard Mokgabodi	012-315 5936	<a href="mailto:Bernard.Mokgabodi@treasury.gov.za">Bernard.Mokgabodi@treasury.gov.za</a>
	Johan Botha	012-315 5171	<a href="mailto:Johan.Botha@treasury.gov.za">Johan.Botha@treasury.gov.za</a>
Limpopo	Una Rautenbach	012-315 5700	<a href="mailto:Una.Rautenbach@treasury.gov.za">Una.Rautenbach@treasury.gov.za</a>
	Sifiso Mabaso	012-315 5952	<a href="mailto:Sifiso.Mabaso@treasury.gov.za">Sifiso.Mabaso@treasury.gov.za</a>
Mpumalanga	Willem Voigt	012-315 5830	<a href="mailto:Willem.Voigt@treasury.gov.za">Willem.Voigt@treasury.gov.za</a>
	Mandla Gilimani	012-315 5807	<a href="mailto:Mandla.Gilimani@treasury.gov.za">Mandla.Gilimani@treasury.gov.za</a>
Northern Cape	Jordan Maja	012-315 5663	<a href="mailto:Jordan.Maja@treasury.gov.za">Jordan.Maja@treasury.gov.za</a>
	Anthony Moseki	012-315 5174	<a href="mailto:Anthony.Moseki@treasury.gov.za">Anthony.Moseki@treasury.gov.za</a>
North West	Sadesh Ramjathan	012-315 5101	<a href="mailto:Sadesh.Ramjathan@treasury.gov.za">Sadesh.Ramjathan@treasury.gov.za</a>
	Makgabo Mabotja	012-315 5156	<a href="mailto:Makgabo.Mabotja@treasury.gov.za">Makgabo.Mabotja@treasury.gov.za</a>
Western Cape	Vuyo Mbunge	012-315 5661	<a href="mailto:Vuyo.Mbunge@treasury.gov.za">Vuyo.Mbunge@treasury.gov.za</a>
	Kevin Bell	012-315 5725	<a href="mailto:Kevin.Bell@treasury.gov.za">Kevin.Bell@treasury.gov.za</a>
	Sibusiso Mahlangu	012-395 6737	<a href="mailto:Sibusiso.Mahlangu@treasury.gov.za">Sibusiso.Mahlangu@treasury.gov.za</a>
Technical issues with Excel formats	Elsabe Rossouw	012-315 5534	<a href="mailto:lgdataqueries@treasury.gov.za">lgdataqueries@treasury.gov.za</a>

National Treasury, together with the provincial treasuries, will undertake a compliance check and, where municipalities have not provided complete budget information, the municipal budgets will be returned to the mayors and municipal managers of the affected municipalities for the necessary corrections. Municipal managers are reminded that the annual budget must be accompanied by a quality certificate and council resolution in accordance with the format specified in item 31 of Schedule A of the Municipal Budget and Reporting Regulations.

The National Treasury would like to emphasise that where municipalities have not adhered to the Municipal Budget and Reporting Regulations, ***they will be required to go back to the municipal council and table a complete budget document aligned to the requirement of the Municipal Budget and Reporting Regulations. In addition, where municipalities have adopted an unfunded budget, they will be required to correct the budget to ensure it adopt and implement a funded budget. However, where there are challenges the process indicated in paragraph 6.1 above will be applied.***

Municipalities with municipal entities are once again reminded to prepare consolidated budgets and in-year monitoring reports for both the parent municipality and its entity or entities. The following must be compiled:

- An annual budget, adjustments budget and monthly financial reports for the parent municipality in the relevant formats;
- An annual budget, adjustments budget and monthly financial reports for the entity in the relevant formats; and
- A consolidated annual budget, adjustments budget and monthly financial reports for the parent municipality and all its municipal entities in the relevant formats.

The A Schedule that the municipality submits to National Treasury must be a consolidated budget for the municipality (plus entities) and the budget of the parent municipality. D schedules must be submitted for each entity.

## **7. Budget process and submissions for the 2018/19 MTREF**

### **7.1 Submitting budget documentation and schedules for 2018/19 MTREF**

To facilitate oversight of compliance with the Municipal Budget and Reporting Regulations, accounting officers are reminded that:

- Section 22(b)(i) of the MFMA requires that, ***immediately*** after an annual budget is tabled in a municipal council, it must be submitted to the National Treasury and the relevant provincial treasury in both printed and electronic formats. If the annual budget is tabled to council on 29 March 2018, the final date of submission of the electronic budget documents and corresponding electronic returns is **Tuesday, 03 April 2018**. The deadline for submission of hard copies including council resolution is **Friday, 06 April 2018**.
- Section 24(3) of the MFMA, read together with regulation 20(1), requires that the approved annual budget must be submitted to both National Treasury and the relevant provincial treasury ***within ten working days*** after the council has approved the annual budget. If the council only approves the annual budget on 30 June 2018, the final date for such a submission is **Friday, 13 July 2018**, otherwise an earlier date applies.

The municipal manager must submit:

- the budget documentation as set out in Schedule A (version 6.2) of the Municipal Budget and Reporting Regulations, including the main Tables (A1 - A10) and ALL the supporting tables (SA1 – SA38) in both printed and electronic formats;
- the draft service delivery and budget implementation plan in both printed and electronic format;
- the draft integrated development plan;
- the council resolution;
- signed Quality Certificate as prescribed in the Municipal Budget and Reporting Regulations; and

- schedules D specific for the entities.

Municipalities are required to send electronic versions of documents and the A1 schedule to [lgdocuments@treasury.gov.za](mailto:lgdocuments@treasury.gov.za). Any problems experienced in this regard can be addressed with Elsabe Rossouw at [Elsabe.Rossouw@treasury.gov.za](mailto:Elsabe.Rossouw@treasury.gov.za). Budget related documents and schedules may also be uploaded using the LG Upload Portal at <https://portals.treasury.gov.za/sites/LGUploadPortal/SitePages/Home.aspx>

Municipalities are required to send printed submissions of their budget documents and council resolution to:

***For couriered documents***

Ms Linda Kruger  
National Treasury  
40 Church Square  
Pretoria, 0002

***For posted documents***

Ms Linda Kruger  
National Treasury  
Private Bag X115  
Pretoria, 0001

In addition to the above-mentioned budget documentation, metropolitan municipalities must submit the draft Built Environment Performance Plan (BEPP) tabled in council by 31 March 2018 to [Yasmin.coovadia@treasury.gov.za](mailto:Yasmin.coovadia@treasury.gov.za). If the BEPP documents are too large to be sent via email (exceeds 4MB) please submit to [yasmin.coovadia@gmail.com](mailto:yasmin.coovadia@gmail.com) or send to Yasmin Coovadia via Dropbox; any problems experienced in this regard can be addressed with [Yasmin.Coovadia@treasury.gov.za](mailto:Yasmin.Coovadia@treasury.gov.za). Hard copies of the BEPP may be sent to Yasmin Coovadia, National Treasury, 3<sup>rd</sup> floor 40 Church Square, Pretoria, 0002 or Private Bag X115, Pretoria, 0001.

## **7.2 Budget reform returns to the Local Government Database for publication**

Municipalities are required to continue to use the Budget Reform Returns to upload budget and monthly expenditure to the National Treasury Local Government Database for publication purposes. All returns are to be sent to [lgdatabase@treasury.gov.za](mailto:lgdatabase@treasury.gov.za). Municipalities must submit returns for both the draft budget and the final adopted budget as this will assist the National and provincial treasuries with the annual benchmark process. The current electronic returns may be downloaded from National Treasury's website at the following link: [http://mfma.treasury.gov.za/Return\\_Forms/Pages/default.aspx](http://mfma.treasury.gov.za/Return_Forms/Pages/default.aspx).

The tabled and adopted budget data strings submitted to the Local Government Database and Reporting system should also be consolidated figures.

## **7.3 In-year reporting**

### ***The impact of mSCOA on in-year reporting***

Municipalities must submit the mSCOA compliant data strings to the LG Upload Portal. National Treasury will continue with parallel reporting using the old format (return forms) and the mSCOA data strings until it is satisfied that all municipalities are mSCOA compliant and reporting adequately to support all publications. Therefore, the data submitted using both reporting methods must reconcile. National and Provincial treasuries together with the municipalities will conduct monthly verification of the data strings, Schedules C and the return forms to ensure that corrections are effected. All corrections must be done by **28 February 2018** in line with the amendments to the adjustments.



### ***Supporting documents to be submitted with Section 71 monthly reports***

Municipalities were advised in MFMA Circular No. 67 that they must provide the following additional information and supporting documentation to the National Treasury as part of the submission of the Section 71 input forms:

- An extract of the trial balances from the general ledger;
- Copies of the actual monthly bank statements (reflecting the opening and closing bank balances) for the primary bank account;
- Bank reconciliation for the reporting period in the primary bank account; and
- Copies of the quarterly tabled section 71 documents in the prescribed Schedule C format including the applicable council resolution.

Most municipalities have not followed the guideline; therefore, municipalities are reminded that this request is still applicable and that the information must be submitted with the monthly Section 71 reports. The information is meant to assist in improving the quality of the quarterly published local government performance information.

### ***Monthly reporting of debtors and creditors***

National Treasury has observed through in-year monitoring that most municipalities are overstating debtors as they report on gross debtors instead of net. The format of the monthly debtors return form (Age Analysis of Debtors) provides for a column to disclose provision for impairment as per council policy. Therefore municipalities are urged to always reflect the provision for impairment in the column as indicated above for National Treasury to be able to reconcile the net debtors.

It was also observed that most municipalities are understating outstanding creditors. There is a major difference in the amounts reported through in-year reporting and those disclosed in the annual financial statements. It is assumed that amounts are not disclosed for all sundry payments and contractual commitments. Municipalities are urged to reconcile creditors on a monthly basis to increase the quality of reporting and for effective cash flow management.

## **7.4 Budget verification process**

Annually during the budget verification process it is noted that municipalities have challenges to align the audited years, which results in amendments to the Schedule A. Municipalities must ensure that the audited figures and adjusted budget figures captured on the Schedule A aligns to the annual financial statements and Schedule B respectively.

## **7.5 Publication of budgets on municipal websites**

In terms of section 75 of the MFMA, all municipalities are required to publish their tabled budgets, adopted budgets, annual reports (containing audited annual financial statements) and other relevant information on the municipality's website. This will aid in promoting public accountability and good governance.

All relevant documents mentioned in this circular are available on the National Treasury website, <http://mfma.treasury.gov.za/Pages/Default.aspx>. Municipalities are encouraged to visit it regularly as documents are regularly added / updated on the website.



## Contact



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

**Post** Private Bag X115, Pretoria 0001  
**Phone** 012 315 5009  
**Fax** 012 395 6553  
**Website** <http://www.treasury.gov.za/default.aspx>

**JH Hattingh**  
**Chief Director: Local Government Budget Analysis**  
**08 December 2017**

## Annexure A – Changes to mSCOA version 6.2

No.	Segment	Amendment
1	Region	Include ward / township breakdown as requested by municipalities
2	Region	Retired decommissioned municipalities due to demarcation
3	Region	Updated name changes due to demarcation and gazette notifications received
4	Item Revenue: Licences or permits	Added item for revenue from Atmospheric Emission Licence Fees
5	Item Expenditure: Depreciation	Added breakdown of asset classification to align to the CIDMS classification and SA34d
6	Item Expenditure: Remuneration of councillors	Added remuneration of Section 79 chairperson as this needs to be reported separately
7	Item Expenditure: Contracted services	Added line item for outsourced printing services
8	Item Expenditure: Operational cost: Licences	Added line item for liquor licence (entities)
9	Item Expenditure	Added "Transfer to Accumulated Surplus" account
10	Item Expenditure	Added "Capitalisation" accounts to capitalise materials, plant and vehicle costs
11	Item Assets: Investments	Report at institution level and breakdown detail for own purposes.
12	Item Assets: Current Accounts: Control, Clearing and Interface Accounts	Added line item for mistakes made by bank (over/ under banking, unidentified deductions from bank account)
13	Item: Assets, Liabilities and Net Assets	Removed all "Closing Balance" accounts
14	Item Assets and Liabilities	Added "Opening Balance" accounts, detail to be carried in the sub-system
15	Function	Expanded definition descriptions to guide municipalities on the difference between core and non-core functions
16	Fund	Added breakdown of grants, transfers and subsidies as requested by municipalities
17	Fund	Aligned Fund, Item Liabilities, Item Expenditure and Item Revenue segments
18	Project	Changed breakdown allowed to "Yes" for 8 items that indicated "breakdown required but principle N/A".

# Municipal Budget Circular for the 2018/19 MTREF

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## Introduction

This budget circular is a follow-up to the one issued in December 2017. It guides municipalities with their preparation of the 2018/19 Medium Term Revenue and Expenditure Framework (MTREF) and, as with previous annual budget circulars it should be read within this context. Among the objectives of this Circular, is to support municipalities with giving effect to National Treasury's Municipal Budget and Reporting Regulations (MBRR) within the current economic climate. The key focus of this Circular is the grant allocations per the 2018 Budget Review and the 2018 Division of Revenue Bill.

### 1. The South African economy and inflation targets

The 2018 Budget Review emphasised that, although global risk factors remain elevated, the world economy continues to provide a supportive platform for South Africa to expand trade and investment. The world economic growth is at its highest since 2014 and continues to gather pace with Gross Domestic Product (GDP) growth increasing across all major economies.

South Africa has experienced a period of protracted economic weakness which diminishes private investment. This may be attributed to domestic constraints, associated to political uncertainty, and declining business and consumer confidence. The local economy is beginning to recover after a short recession in early 2017 however the improvement is insufficient. Growth has remained stagnant at less than 2 per cent and unemployment remains high at 26.7 per cent. The prerequisites for increased revenue and expanded service delivery are more rapid growth, investment and job creation.

The GDP growth rate is forecasted at 1.5 per cent in 2018, 1.8 per cent in 2019 and 2.1 per cent in 2020. Statistics South Africa's December 2017 economic statistics showed an unexpected improvement in the economic outlook, largely as a result of growth in agriculture and mining.

The main risks to the economic outlook are continued policy uncertainty and deterioration in the finances of state-owned entities. The drought experienced in several provinces poses significant risks to agriculture and tourism for the period ahead, and this may threaten jobs in these sectors. The current water crisis in the Western Cape and other provinces will affect economic growth. While the drought's impact is uncertain much depends on how long it will prevail; the extent to which specific catchment areas are affected; and the success of mitigation measures.

These economic challenges will continue to exert pressure on municipal revenue generation and collection levels hence a conservative approach is advised for revenue projections. Municipalities affected by the drought should also consider its impact on revenue generation. In addition, municipalities will have to improve their efforts to limit non-priority spending and to implement stringent cost-containment measures.

The following macro-economic forecasts must be considered when preparing the 2018/19 MTREF municipal budgets.

**Table 1: Macroeconomic performance and projections, 2017 - 2020**

Fiscal year	2017/18	2018/19	2019/20	2020/21
	Estimate	Forecast		
Consumer Price Inflation (CPI)	5.3%	5.3%	5.4%	5.5%
Real GDP growth	1.0%	1.5%	1.8%	2.1%

*Source: 2018 Budget Review.*

*Note: the fiscal year referred to is the national fiscal year (April to March) which is more closely aligned to the municipal fiscal year (July to June) than the calendar year inflation.*

## **2. Key focus areas for the 2018/19 budget process**

### **2.1 Local government grants and additional allocations**

Since the 2017 Medium Term Budget Policy Statement (MTBPS) reprioritisation and reductions undertaken have affected planned spending for 2018/19. Local government direct and indirect transfers absorb 18.8 per cent of the reductions. A total of R13.9 billion has been cut from direct local government conditional grant allocations for the Medium Term Expenditure Framework (MTEF) period ahead since the 2017 MTBPS was tabled. Indirect grants to local government have been reduced by an additional R2.2 billion.

The reductions did not affect all conditional grants, and not all grants were reduced by the same percentage. The infrastructure conditional grants, particularly the larger ones, were mainly affected as this was considered the most practical approach. The overall impact of reducing this funding affects capital programmes; therefore local government's share of the reductions is higher than their share of the division of revenue, given that municipalities receive a number of infrastructure grants. The average reductions over the medium term are 3.5 per cent of local government allocations.

Conditional grant funding targets delivery of national government's service delivery priorities. It is imperative that municipalities understand and comply with the conditions stipulated in the Division of Revenue Act (DoRA) in order to access this funding. The equitable share and the sharing of the general fuel levy constitute additional unconditional funding, of which the equitable share is designed to fund the provision of free basic services to disadvantaged communities.

Allocations to the local government equitable share will continue to grow over the next three years, alongside a significant reduction in conditional grants. The total value of conditional grants directly transferred to local government increases from R43.3 billion in 2018/19 to R44.8 billion in 2019/20 and R47.8 billion in 2020/21.

Large municipalities are expected to invest more of their own resources, offsetting some of the impact of reductions to infrastructure grants, while building partnerships with the private sector for infrastructure delivery over the period ahead.

The 2018 Budget provides for R382.8 billion to be transferred directly to local government and a further R21.8 billion allocated to indirect grants for the 2018 MTREF. Direct transfers to local government over the medium term account for 9 per cent of national government's non-interest expenditure. Total direct allocations to local government grow at an annual average rate of 7.5 per cent over the MTEF period. The total spending on local government increases to 9.5 per cent of national non-interest expenditure when adding indirect transfers.

Municipalities are reminded that all allocations included in their budgets must correspond to the allocations listed in the Division of Revenue Bill. All the budget documentation can be accessed from the National Treasury website by clicking on the link below:  
<http://www.treasury.gov.za/documents/national%20budget/2018/>

### ***Changes to local government allocations***

## Unconditional grants

An amount of R3.4 billion is added to the *local government equitable share* over the medium term to compensate for the rising costs of providing free basic services to the growing number of indigent households. This covers the likely above-inflation increases in the costs of bulk water and electricity. This also allows for faster increases in the allocations to poorer and rural municipalities through the redistributive components of the equitable share formula. This allocation is in addition to the previous increases and an above inflation growth rate for the baseline in 2020/21. This means that the local government equitable share grows at an annual average rate of 10.4 per cent over the MTEF.

## Conditional grants

The most substantial reduction has been applied to the largest grant – the *municipal infrastructure grant*. However, the structure of the formula used to allocate this grant reduces the impact of reductions on smaller municipalities. Project-based grants, such as those in the electricity and water sectors, have identified projects that will be postponed as a result of the adjustments. These changes do not affect any water augmentation projects in drought-affected areas.

Reductions to the *public transport network grant* are much larger in the outer years of the MTEF. This allows for the Department of Transport and the National Treasury to review the sustainability of public transport plans and to assess whether some cities should put projects on hold while they revisit system design.

The 2017 MTBPS announced a new funding mechanism to support recovery plans for municipalities that face a financial crisis, as provided for in section 139(5) of the Constitution. A *new municipal restructuring grant* will be introduced to help municipalities in financial crisis to implement reforms to turn themselves around. The National Treasury will consult with national departments, provinces and South African Local Government Association (SALGA) on the design of the grant and its coordination with other capacity-building programmes during 2018. The grant is intended to be a short-term intervention that will fund the turnaround of struggling municipalities. It will help identified municipalities that are in financial distress, but have demonstrated a commitment to implementing the necessary reforms. If needed, the intervention powers outlined in section 139 of the Constitution may also be used as part of the broader approach to turning around these municipalities.

The municipal restructuring grant will be made available within the parameters of the existing legal framework and will not provide bailouts to municipalities. It will fund the implementation of specific outputs in support of a financial recovery plan approved by a municipal council. The council must demonstrate political buy-in by adopting such a plan, and the municipality must also commit its own resources to implementing parts of the plan.

Smaller cities face some of the same urban development challenges as major metropolitan areas. These cities will be eligible for a *new integrated urban development grant* from 2019/20. Cities will have to meet planning and performance criteria to receive the grant, which will be funded through a shift of funds from the municipal infrastructure grant. The new grant will require cities to plan for a programme of infrastructure investment, funded from grants and own revenues, rather than just standalone projects. This aligns with the policy set out in the Integrated Urban Development Framework (IUDF) approved by Cabinet in April 2016. This approach will be piloted in uMhlathuze and Polokwane local municipalities in 2018/19. Eligible municipalities will be invited to apply for the grant during 2018. The application process is set out in clause 27(5) of the 2018 Division of Revenue Bill.

## 2.2 Drought disaster relief

Severe drought conditions are affecting large parts of the country, and placing extreme strain on the supply of water to the nearly 4 million people in the City of Cape Town. Some smaller towns in the Northern Cape, Eastern Cape and Western Cape, as well as Nelson Mandela Bay Metro, are also facing severe water shortages. The drought has been classified as a national disaster by the National Disaster Management Centre. Government is committed to managing available supply to ensure basic needs are met, while implementing plans to improve long-term sustainability in a water stressed country.

Government is prepared to provide financial assistance as deemed necessary:

- A provisional allocation of R6 billion has been set aside in 2018/19 for drought relief in several provinces, to assist the water sector and to augment public investment projects supported by improved infrastructure planning. Some of these funds may be allocated to support water augmentation projects in an Adjustments Budget, however, the full costs of new schemes will eventually have to be recovered from water users through tariffs.
- The Division of Revenue Act allows for conditional grant funds to be reallocated for disaster relief. Such additional funding may be used in 2017/18 for immediate interventions such as accelerating groundwater development.
- Disaster relief grants for provinces and municipalities are R423.7 million in 2017/18 and R472.9 million in 2018/19. This may be quickly released to assist in the event of an emergency.
- If agricultural employment is seriously destabilised, government can temporarily increase the intake on the Working for Water Programme. These short-term jobs will provide a substitute employment option, while helping to improve runoff in catchment areas by removing alien vegetation.

## 2.3 Participation in RT15-2016 Vodacom transversal contract- for the supply and delivery of mobile communication services to the state

When municipalities make an application to the Office of the Chief Procurement Officer (OCPO) to participate in the RT15-2016 transversal contract's account management service offering in respect of smart meters, they must comply with the process that will be communicated in an MFMA Circular that will soon be issued. In terms of the application process municipalities are expected to provide evidence of adequate operating budget provision over the MTREF. The Circular will include pre-conditions for eligibility to participate, such as adequate resourcing and technology platform to fulfil their obligation as envisaged by the Smart Utility Management Solution; and capability to sustain the implementation effort in the longer term.

## 3. The revenue budget

National Treasury encourages municipalities to maintain tariff increases at levels that reflect an appropriate balance between the affordability to poorer households and other customers while ensuring the financial sustainability of the municipality. The Consumer Price Index (CPI) inflation is forecasted to be within the upper limit of the 3 to 6 per cent target band; therefore municipalities are required to **justify all increases in excess of the projected inflation target for 2018/19** in their budget narratives, and pay careful attention to the differential incidence of tariff increases across all consumer groups. In addition municipalities should

include a detail of their revenue growth assumptions for the different service charges in the budget narrative.

Local government also confronts tough fiscal choices in the face of financial and institutional problems that result in service-delivery breakdowns and unpaid bills. Municipalities can offset these trends by improving own revenue collection, working more efficiently and implementing cost containment measures.

### **3.1 Eskom bulk tariff increases**

The National Energy Regulator of South Africa (NERSA) published their “Municipal Tariff Guideline Increase, Benchmarks and Proposed Timelines for Municipal Tariff Approval Process for the 2018/19 Financial Year” on 28 February 2018. Municipalities are encouraged to download the full guideline document (available at [www.nersa.org.za](http://www.nersa.org.za)) and study it carefully. The guideline includes an update to the average cost structure used to determine the municipal tariff increase. It also sets out proposed timeframes for the approval of municipal tariffs. NERSA invites comments on the guideline to be submitted by 20 March 2018.

The NERSA document proposes a 6.84 per cent guideline increase for municipal electricity tariffs for 2018/19. This is based on a bulk tariff increase for municipalities of 7.32 per cent.

Municipalities are urged to examine the cost structure of providing electricity services and to apply to NERSA for electricity tariff increases that reflect the total cost of providing the service so that they work towards achieving fully cost-reflective tariffs that will help them achieve financial sustainability. Municipalities in arrears with Eskom should ensure that their payment arrangements are effected in their 2018/19 MTREF budget.

It should be noted that the guideline increase for municipal tariffs and the bulk tariff increase that Eskom will charge municipalities are both lower than the 8 per cent used to calculate the free basic electricity subsidies provided through the local government equitable share formula.

## **4. Funding choices and management issues**

### **4.1 Management issues**

Many municipalities continue to face institutional challenges and mismanagement that result in service delivery failures, bad debt accumulation, limited cash flows and consequent non-payment of creditors. Eskom and water boards are owed the greater percentage of the total municipal creditors; and protracted non-payment undermines the financial sustainability of these state-owned entities.

The non-payment of creditors is a symptom of underlying problems which include, among others, weaknesses in revenue collection and underinvestment in asset maintenance and renewal, which compromises the reliability of delivering basic services. There are too many municipalities that fail to adopt credible budgets and this means that even if they adhere to their budgeted plans, they will not be financially sustainable.

The national and provincial departments collectively owe municipalities and while much of the historic debt has been verified by the Department of Public Works there are departments that do not have sufficient funds to settle these debts. The Department of Public Works continues to facilitate the ongoing government debt verification and settlement process.

In order to achieve financial sustainability, municipalities must demonstrate the political will to implement the changes required to improve their performance. Where municipalities



consistently fail to deliver their mandates, the Constitution provides for provincial and/or national government to intervene.

Government will introduce a conditional grant in the outer years of the 2018 MTEF to provide support to municipalities facing financial crises. This grant funding will only be accessible to municipalities that have demonstrated the political will to implement reforms necessary to turn themselves around. The grant will be designed and consulted during 2018.

#### **4.2 Employee related costs**

The *Salary and Wage Collective Agreement* for the period 01 July 2015 to 31 June 2018 has come to an end. The process is under consultation; therefore, in the absence of other information from the South African Local Government Bargaining Council communication will be provided at a later stage.

#### **4.3 Remuneration of councilors**

Municipalities are advised to budget for the actual costs approved in accordance with the Government Gazette on the Remuneration of Public Office Bearers Act: Determination of Upper Limits of Salaries, Allowances and Benefits of different members of municipal councils published annually between December and January by the Department of Cooperative Governance. Any overpayment to councilors contrary to the upper limits as published by the Minister of Cooperative Governance and Traditional Affairs will be irregular expenditure in terms of section 167 of the MFMA and must be recovered from the councilor(s) concerned.

### **5. Conditional Grant Transfers to Municipalities**

This section provides guidance to municipalities with regard to the preparation for the 2017/18 unspent conditional grant and roll-over process and should be referenced to previous annual budget circulars.

#### **5.1 Criteria for the rollover of conditional grant funds**

Section 22 of the 2017 Division of Revenue Act (DoRA) requires that any conditional grants which are not spent at the end of the municipal financial year must revert to the National Revenue Fund, unless the receiving officer, provincial treasury and transferring national officer proves to the satisfaction of National Treasury that the unspent allocation is committed to identifiable projects, in which case the funds may be rolled over.

When applying to retain unspent conditional allocations committed to identifiable projects or requesting a rollover in terms of section 22(2) of the DoRA, municipalities must include the following information with their submission to National Treasury:

1. A formal letter, signed by the accounting officer must be addressed to the **National Treasury** requesting the rollover of unspent conditional grants in terms of section 22(2) of the 2017 DoRA;
2. A list of all the projects that are linked to the unspent conditional grants and a breakdown of how much was allocated and spent per project;
3. The following evidence indicating that work on each of the projects has commenced, as applicable to the specific rollover(s):
  - a) Proof that the project tender was published and the period for tender submissions closed before 31 March;
  - b) Proof that a contractor or service provider was appointed for delivery of the project before 31 March; or

- c) Proof of a project tender, appointment of contractor or service provider for delivery of service before 30 June in cases where additional funding was allocated during the course of the final year of the project; and
  - d) Evidence that all projects linked to an allocation will be fully utilised by 30 June 2019 (attach cash flow projection for the applicable grant).
4. A progress report (also in percentages) on the status of each project's implementation (**attach a visible implementation plan**);
  5. The value of the committed project funding, and the conditional allocation from the funding source;
  6. Reasons why the grants were not fully spent during the year of original allocation per the DoRA;
  7. Municipalities must not include previous year's unspent conditional grants as a rollover request. Rollover of rollovers will not be considered;
  8. An indication of the time-period within which the funds are to be spent if the roll over is approved; and
  9. Proof that the Chief Financial Officer and Municipal Manager are permanently appointed.

***No rollover requests will be considered for municipalities with vacant or acting Chief Financial Officers and Municipal Managers for a period exceeding 6 months from the date of vacancy.***

**If any of the above information is not provided or the application is received by National Treasury (Intergovernmental Relations Division) after 31 August 2018, the application will be declined.**

In addition, National Treasury will also consider the following information when assessing rollover applications; and reserves the right to decline an application should there be non-performance by the municipality in any of these areas:

1. Compliance with the in-year reporting requirements in terms of sections 71 and 72 of the MFMA and section 12 of the 2017 DoRA, including the municipal manager and chief financial officer signing-off on the information sent to National Treasury;
2. Submission of the pre-audited Annual Financial Statements information to National Treasury by 31 August 2018;
3. Accurate disclosure of grant performance in the 2017/18 pre-audited Annual Financial Statements, (i.e. correct disclosure of grant receipts and spending in the notes to the AFS);
4. The National Treasury will not consider requests to approve the entire allocation to the municipality as there should be a minimum spend of 50 per cent of the allocation per programme;
5. Cash available in the bank (net position including short term investments) as at 30 June 2018 and in line with the cash flow statements to finance the roll-over request;
6. No approval will be granted to municipalities requesting a roll-over of the same grant for the third consecutive time;
7. Incorporation of the Appropriation Statement;
8. No roll over application project constituted through Regulation 32 of the Municipal Supply Chain Management Regulations (Gazette No.27636) will be approved. Projects linked to additional funding and disasters are exempted;
9. If the full amount that is requested for roll over is not entirely cash backed, such a roll over will not be approved. National Treasury will not approve portions of roll over requests; and
10. Evidence that the roll over application is linked to invoices that were issued within the last 30 days of the municipal financial year end.

## 5.2 Unspent conditional grant funds for 2017/18

The process to ensure the return of unspent conditional grants for the 2017/18 financial year will be managed in accordance with section 22 of the DoRA. In addition to the previous MFMA circulars, the following practical arrangements will apply:

- Step 1: Municipalities must submit their June 2018 conditional grant expenditure reports according to section 71 of the MFMA reflecting all accrued expenditure on conditional grants and further ensure that expenditure reported to both National Treasury and national transferring officers reconcile.
- Step 2: When preparing the Annual Financial Statements a municipality must determine the portion of each national conditional grant allocation that remained unspent as at 30 June 2018. These amounts **MUST** exclude all interest earned on conditional grants, retentions and VAT related to conditional grant spending that has been reclaimed from SARS, which must be disclosed separately.
- Step 3: If the receiving officer wants to motivate in terms of section 22(2) of the 2017 DoRA that the unspent funds are committed to identifiable projects, the roll over application pack must be submitted to National Treasury by 31 August 2018.

***National Treasury will not consider any rollover requests that are incomplete or received after this deadline.***

- Step 4: National Treasury will confirm in writing whether or not the municipality may retain any of the unspent funds as a rollover based on criteria outlined above by 22 October 2018 or whether it will agree to any alternative payment arrangement or schedules.
- Step 5: National Treasury will communicate the unspent conditional grants amount by 05 November 2018. A municipality must return the remaining unspent conditional grant funds that are not subject to a specific repayment arrangement to the National Revenue Fund by 19 November 2018.
- Step 6: Any unspent conditional grant funds that should have, but has not been repaid to the National Revenue Fund by 19 November 2018, and for which a municipality has not requested a repayment arrangement, will be offset against the municipality's 03 December 2018 equitable share allocation.

**All other issues pertaining to Appropriation Statement and reporting on approved roll overs are addressed in the Annexure to MFMA Circular No. 86.**

## 6. The Municipal Budget and Reporting Regulations

### 6.1 The impact of VAT increase on tariffs

VAT will increase from 14 per cent to 15 per cent from April 2018. In terms of Section 7(4) of Value-Added Tax Act (No. 89 of 1991), the VAT increase takes effect on 1 April. It is a tax increase as result of tax legislation that municipalities must implement and not an increase of tariffs by the municipalities. Therefore Section 28(6) of the Municipal Finance Management Act, 2003 (No. 56 of 2003) (MFMA), is not applicable in this regard.

Whether the additional amount is recoverable from the customer or not, the supplier must account for VAT on any supplies made on or after 1 April 2018 at the increased VAT rate.

The South African Revenue Service issued a guideline on how the increase in VAT must be implemented. The guideline is available on the link below:

<http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-VAT-G13%20-%20VAT%20Pocket%20Guide%20on%20the%20VAT%20rate%20increase%20on%201%20April%202018%20-%20External%20Guide.pdf>

## 6.2 Schedule A - version to be used for the 2018/19 MTREF

National Treasury has released Version 6.2 of Schedule A1 (the Excel Formats) which is aligned to version 6.2 of the mSCOA classification framework which must be used when compiling the 2018/19 MTREF budget. **ALL** municipalities **MUST** use this version for the preparation of their 2018/19 MTREF budget.

***It is imperative that all municipalities prepare their 2018/19 MTREF budgets in their mSCOA financial systems and that the A1 schedule be produced directly from their financial system. All financial systems must have this functionality to assist and prepare budgets.***

Special attention must be given to the supporting schedules in the prescribed A1 Schedule. Where detailed data is housed in a sub-system e.g. human resource data for SA22 to SA24, this data must be extracted from the sub-system into the applicable supporting sheet.

The following supporting tables will be included for perusal and sign-off during the verification process of the 2018 MTREF: SA11, SA12a, SA13a, SA14, SA22, SA23, SA24, SA25, SA27, SA36, SA37 and SA38.

It is therefore important to focus on the additional supporting data as well as the financial data submitted on A1 to A10 during the verification process undertaken with National Treasury, the provincial treasuries and all municipalities.

Download Version 6.2 of Schedule A1 by clicking [HERE](#)

The Municipal Budget and Reporting Regulations, formats and associated guides are available on National Treasury's website at:

<http://mfma.treasury.gov.za/RegulationsandGazettes/Pages/default.aspx>

## 6.3 Assistance with the compilation of budgets

In cases where the municipality requires advice with the compilation of their respective budgets, specifically the budget documents or Schedule A1, they should direct their enquiries to their respective provincial treasuries or to the following National Treasury official:

Province	Responsible NT officials	Tel. No.	Email
Eastern Cape	Bernard Mokgabodi	012-315 5936	<a href="mailto:Bernard.Mokgabodi@treasury.gov.za">Bernard.Mokgabodi@treasury.gov.za</a>
	Matjatji Mashoeshoe	012-315 5553	<a href="mailto:Matjatji.Mashoeshoe@treasury.gov.za">Matjatji.Mashoeshoe@treasury.gov.za</a>
Free State	Jordan Maja	012-315 5663	<a href="mailto:Jordan.Maja@treasury.gov.za">Jordan.Maja@treasury.gov.za</a>
	Cethekile Moshane	012-315 5079	<a href="mailto:Cethekile.moshane@treasury.gov.za">Cethekile.moshane@treasury.gov.za</a>
Gauteng	Kgomotso Baloyi	012-315 5866	<a href="mailto:Kgomotso.Baloyi@treasury.gov.za">Kgomotso.Baloyi@treasury.gov.za</a>

	Nomxolisi Mawulana	012-315 5460	<a href="mailto:Nomxolisi.Mawulana@treasury.gov.za">Nomxolisi.Mawulana@treasury.gov.za</a>
KwaZulu-Natal	Bernard Mokgabodi Johan Botha	012-315 5936 012-315 5171	<a href="mailto:Bernard.Mokgabodi@treasury.gov.za">Bernard.Mokgabodi@treasury.gov.za</a> <a href="mailto:Johan.Botha@treasury.gov.za">Johan.Botha@treasury.gov.za</a>
Limpopo	Una Rautenbach Sifiso Mabaso	012-315 5700 012-315 5952	<a href="mailto:Una.Rautenbach@treasury.gov.za">Una.Rautenbach@treasury.gov.za</a> <a href="mailto:Sifiso.Mabaso@treasury.gov.za">Sifiso.Mabaso@treasury.gov.za</a>
Mpumalanga	Willem Voigt Mandla Gilimani	012-315 5830 012-315 5807	<a href="mailto:Willem.Voigt@treasury.gov.za">Willem.Voigt@treasury.gov.za</a> <a href="mailto:Mandla.Gilimani@treasury.gov.za">Mandla.Gilimani@treasury.gov.za</a>
Northern Cape	Jordan Maja Anthony Moseki	012-315 5663 012-315 5174	<a href="mailto:Jordan.Maja@treasury.gov.za">Jordan.Maja@treasury.gov.za</a> <a href="mailto:Anthony.Moseki@treasury.gov.za">Anthony.Moseki@treasury.gov.za</a>
North West	Sadesh Ramjathan Makgabo Mabotja	012-315 5101 012-315 5156	<a href="mailto:Sadesh.Ramjathan@treasury.gov.za">Sadesh.Ramjathan@treasury.gov.za</a> <a href="mailto:Makgabo.Mabotja@treasury.gov.za">Makgabo.Mabotja@treasury.gov.za</a>
Western Cape	Vuyo Mbunge Kevin Bell	012-315 5661 012-315 5725	<a href="mailto:Vuyo.Mbunge@treasury.gov.za">Vuyo.Mbunge@treasury.gov.za</a> <a href="mailto:Kevin.Bell@treasury.gov.za">Kevin.Bell@treasury.gov.za</a>
Technical issues with Excel formats	Elsabe Rossouw	012-315 5534	<a href="mailto:lgdataqueries@treasury.gov.za">lgdataqueries@treasury.gov.za</a>

National Treasury, together with the provincial treasuries, will undertake a compliance check and, where municipalities have not provided complete budget information, the municipal budgets will be returned to the mayors and municipal managers of the affected municipalities for the necessary corrections. Municipal managers are reminded that the annual budget must be accompanied by a quality certificate and council resolution in accordance with the format specified in item 31 of Schedule A of the Municipal Budget and Reporting Regulations. In addition to the above compliance check, the *mSCOA* data strings will be assessed to determine whether the municipalities are compliant.

The National Treasury herewith emphasises that where municipalities have not adhered to the Municipal Budget and Reporting Regulations, ***they will be required to return to the municipal council and table a complete budget document aligned to the requirement of the Municipal Budget and Reporting Regulations.***

Municipalities with municipal entities are once again reminded to prepare consolidated budgets and in-year monitoring reports for both the parent municipality and its entity or entities. The following must be compiled:

- An annual budget, adjustments budget and monthly financial reports for the parent municipality in the relevant formats;
- An annual budget, adjustments budget and monthly financial reports for the entity in the relevant formats; and
- A consolidated annual budget, adjustments budget and monthly financial reports for the parent municipality and all its municipal entities in the relevant formats.

The Schedule A that the municipality submits to National Treasury must be a consolidated budget for the municipality (plus entities) and the budget of the parent municipality. Schedules D must be submitted for each entity.

## 7. Budget process and submissions for the 2018/19 MTREF

### 7.1 Budgeting for the audited years on Schedule A (*mSCOA*)

According to international learning practices, it is appropriate to reclassify historical information in accordance with the changes that occur in the Standard Chart of Accounts. Municipalities must capture the reclassified audit outcomes for 2014/15 to 2016/17 in version 6.2 of the Schedule A when compiling 2018/19 MTREF budgets.

The amalgamated municipalities must complete the 2016/17 audited years, current year (2017/18) and the 2018/19 MTREF budgets.

## 7.2 Submitting budget documentation and schedules for 2018/19 MTREF

To facilitate oversight of compliance with the Municipal Budget and Reporting Regulations, accounting officers are reminded that:

- Section 22(b)(i) of the MFMA requires that, **immediately** after an annual budget is tabled in the municipal council, it must be submitted to the National Treasury and the relevant provincial treasury in both printed and electronic formats. If the annual budget is tabled to council on 29 March 2018, the final date of submission of the electronic budget documents and corresponding electronic returns is **Tuesday, 03 April 2018**. The deadline for submission of hard copies including council resolution is **Friday, 06 April 2018**.
- Section 24(3) of the MFMA, read together with regulation 20(1), requires that the approved annual budget must be submitted to both National Treasury and the relevant provincial treasury **within ten working days** after the council has approved the annual budget. If the council only approves the annual budget on 30 June 2018, the final date for such a submission is **Friday, 13 July 2018**, otherwise an earlier date applies.

The municipal manager must submit:

- the budget documentation as set out in Schedule A (version 6.2) of the Municipal Budget and Reporting Regulations, including the main Tables (A1 - A10) and ALL the supporting tables (SA1 – SA38) in both printed and electronic formats;
- the draft service delivery and budget implementation plan in both printed and electronic format;
- the draft integrated development plan;
- the council resolution;
- signed Quality Certificate as prescribed in the Municipal Budget and Reporting Regulations;
- the budget locking certificate; and
- schedules D specific for the entities.

Municipalities are required to send electronic versions of documents and the A1 schedule to [lgdocuments@treasury.gov.za](mailto:lgdocuments@treasury.gov.za). Any problems experienced in this regard can be addressed with Elsabe Rossouw at [Elsabe.Rossouw@treasury.gov.za](mailto:Elsabe.Rossouw@treasury.gov.za). Budget related documents and schedules may also be uploaded using the LG Upload Portal at <https://portals.treasury.gov.za/sites/LGUploadPortal/SitePages/Home.aspx>

Municipalities are required to send printed submissions of their budget documents and council resolution to:

### ***For couriered documents***

Ms Linda Kruger  
National Treasury  
40 Church Square  
Pretoria, 0002

### ***For posted documents***

Ms Linda Kruger  
National Treasury  
Private Bag X115  
Pretoria, 0001

In addition to the above-mentioned budget documentation, metropolitan municipalities must submit the draft Built Environment Performance Plan (BEPP) tabled in council by 31 March 2018 to [Yasmin.coovadia@treasury.gov.za](mailto:Yasmin.coovadia@treasury.gov.za). If the BEPP documents are too large to be sent via email (exceeds 4MB) please submit to [yasmin.coovadia@gmail.com](mailto:yasmin.coovadia@gmail.com) or send to Yasmin Coovadia via Dropbox; any problems experienced in this regard can be addressed with [Yasmin.Coovadia@treasury.gov.za](mailto:Yasmin.Coovadia@treasury.gov.za). Hard copies of the BEPP may be sent to Yasmin Coovadia, National Treasury, 3<sup>rd</sup> floor 40 Church Square, Pretoria, 0002 or Private Bag X115, Pretoria, 0001.

### **7.3 Budget reform returns to the Local Government Database for publication**

Municipalities are required to continue to use the Budget Reform Returns to upload budget and monthly expenditure to the National Treasury Local Government Database for publication purposes. All returns are to be sent to [lgdatabase@treasury.gov.za](mailto:lgdatabase@treasury.gov.za). Although there is some mis-alignment between the *m*SCOA classification and the budget return forms, municipalities must find the best fit to represent their 2018 MTREF budget figures as the publications will still be based on the budget returns for 2018/19.

Municipalities must submit returns for both the **tabled** budget and the final **adopted** budget as this will assist the National and provincial treasuries with the annual benchmark process. The current electronic returns may be downloaded from National Treasury's website at the following link: [http://mfma.treasury.gov.za/Return\\_Forms/Pages/default.aspx](http://mfma.treasury.gov.za/Return_Forms/Pages/default.aspx).

The tabled and adopted budget data strings submitted to the Local Government Database and Reporting system should also be consolidated figures.

### **7.4 Upload of the *m*SCOA budget data strings to the LG upload portal**

Municipalities must upload the *m*SCOA data strings for the tabled (**TABB**) and adopted (**ORGB**) budget to the upload portal. The budget data strings must be accompanied by the IDP project details data strings (**PRTA** and **PROR**). The deadlines for submission of the MBRR documents are also applicable to the *m*SCOA data strings. Refer to paragraph 7.2 above.

### **7.5 Publication of budgets on municipal websites**

In terms of section 75 of the MFMA, all municipalities are required to publish their tabled budgets, adopted budgets, annual reports (including the audited annual financial statements) and other relevant information on the municipality's website. This will aid in promoting transparency and good governance.

All relevant documents mentioned in this circular are available on the National Treasury website, <http://mfma.treasury.gov.za/Pages/Default.aspx>. Municipalities are encouraged to visit it regularly as documents are regularly added / updated on the website.

## Contact



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

**Post** Private Bag X115, Pretoria 0001  
**Phone** 012 315 5009  
**Fax** 012 395 6553  
**Website** <http://www.treasury.gov.za/default.aspx>

**JH Hattingh**

**Chief Director: Local Government Budget Analysis**

**07 March 2018**